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IN THE

Supreme Court of the United States

OCTOBER TERM, 1970

Nos. 541 and 543

No. 541

ARTURO FORNARIS, JR., *Appellant*,

v.

THE RIDGE TOOL CO., ET AL., and
THE COMMONWEALTH OF PUERTO RICO, *Appellees*.

No. 543

THE COMMONWEALTH OF PUERTO RICO, *Appellant*,

v.

THE RIDGE TOOL CO.,
THE RIDGE TOOL INTERNATIONAL CO., INC., and
ARTURO FORNARIS, JR., *Appellees*.

On Appeal from the United States Court of Appeals for the First Circuit

MOTION TO DISMISS OR AFFIRM

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MOTION TO DISMISS OR AFFIRM

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Appellees, Ridge Tool Co. and Ridge Tool International Co., Inc., pursuant to Rule 16 of the Rules of the Supreme Court of the United States, move the Court to dismiss the appeals herein or, in the alter-

native, to affirm the judgment of the United States Court of Appeals for the First Circuit, on the grounds that it is manifest that the questions are so unsubstantial as not to need further argument.*

OPINIONS BELOW

The opinion of the United States Court of Appeals for the First Circuit is reported at 423 F. 2d 563 (1970). It is reprinted at page 31 of the Jurisdictional Statement of Appellant Fornaris and as Appendix A of the Jurisdictional Statement of Appellant The Commonwealth of Puerto Rico.

The unreported Memorandum and Order of the United States District Court for the District of Puerto Rico is reprinted at page 45 of the Jurisdictional Statement of Appellant Fornaris and as Appendix B of the Jurisdictional Statement of Appellant Puerto Rico.

JURISDICTION

These appeals must be dismissed for lack of jurisdiction. Both appeals concede that an appeal to the Supreme Court does not lie in this case by the terms of 28 U.S.C. § 1254 (2) or any other statute. Puerto Rico was apparently never intended by Congress to be regarded as a "State" for purposes of § 1254 (2).

The judicial code underwent complete revision in 1948. At that time § 1252 was revised to include specific mention of the Courts of record of Puerto Rico

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* This motion speaks to both appeals. Each appeal arises out of the same opinions below, and each raises materially identical legal questions. Therefore, Appellees, Ridge Tool Co., et al., believe that consideration by this Court will be simplified and ultimate termination of the litigation will be substantially advanced if Jurisdictional Statements in No. 541 and No. 543 are considered together.

in connection with appeals from invalidation of acts of Congress, C. 646, 62 Stat. 928, June 25, 1948. Congress in 1948 pointedly did not amend § 1254 (2) to provide for appeal to the Supreme Court by any party relying on a Puerto Rican Statute held unconstitutional by a court of appeals.

Congress declined in 1961 another opportunity to revise § 1254 (2). On August 30, 1961, Congress, in recognition of the changed status of Puerto Rico, passed Public Law 87-189, 75 Stat. 417 to amend Title 28 U.S.C. by adding a new § 1258 to provide direct review in the United States Supreme Court by *certiorari* or appeal of the decisions rendered by the Supreme Court of the Commonwealth of Puerto Rico. Neither in the Act itself nor in its legislative history (1961 U.S. Code Cong. and Adm. News, p. 2448), however, was there any hint of Congressional intention to include Puerto Rico within the meaning of "State" in § 1254 (2). In fact it was precisely because Puerto Rico, under its new status, was not a "State" that the 1961 amendment was needed.

Section 2 of Article 3 of the Constitution of the United States does not provide for appellate jurisdiction of the Court except as there specified. All cases not coming within the jurisdictional grant or expressly provided for by legislation are outside the Court's jurisdiction. *Durousseau* v. *United States,* 6 Cranch 307, 314 (1810).

QUESTION PRESENTED

Whether the United States Court of Appeals for the First Circuit erred in holding unconstitutional the Dealers' Contract Law, Law 75 of the Laws of the Commonwealth of Puerto Rico?

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

United States Constitution:

Article I, Section 8, clause 3: "To regulate Commerce . . . among the several States . . ."

Article I, Section 10: "No State shall . . . pass any . . . Law impairing the Obligation of Contracts . . ."

Article IV, Section 3, clause 2: "The Congress shall have power to . . . make all needful Rules and Regulations respecting the Territory or other Property belonging to the United States . . ."

Article VI, clause 2: "This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land."

Amendment V: ". . . nor shall any person . . . be deprived of life, liberty, or property, without due process of law . . ."

Amendment XIV, Section 1: ". . . nor shall any State deprive any person of life, liberty, or property, without due process of law . . ."

Puerto Rican Statute:

Dealers' Contract Law, Law 75, 1964 Laws of Puerto Rico, 10 L.P.R.A. § 278, et seq., is reprinted as amended in 1965 and 1966 at page 62 of the Jurisdictional Statement of Appellant Fornaris and appears as amended in 1965 as Appendix D to the Jurisdictional Statement of Appellant Puerto Rico. The 1966 changes in the Law are not material to the case.

STATEMENT OF THE CASE

This case involves appeals from a decision of the United States Court of Appeals for the First Circuit holding invalid, as repugnant to the due process clause of the federal constitution, Law 75 of the Laws of the Commonwealth of Puerto Rico known as the Dealers' Contract Law.

The action below was initiated in the Superior Court of Puerto Rico, San Juan Part, on September 23, 1966, by Arturo Fornaris, Jr. against The Ridge Tool Co. and its subsidiary The Ridge Tool International Co., Inc.

The complaint alleged that a distribution contract between Fornaris and The Ridge Tool Company was terminated by it on April 15, 1966, in violation of Law 75.

The Ridge Tool Company caused removal of the case on diversity grounds in October 1966 to the United States District Court for the District of Puerto Rico. Ridge Tool moved to dismiss the Fornaris complaint on the ground that Law 75 was unconstitutional. The Commonwealth of Puerto Rico was permitted to intervene to defend the constitutionality of Law 15. On August 11, 1969, the District Court denied the motion to dismiss.

On appeal, pursuant to 28 U.S.C. § 1292(b), the United States Court of Appeals for the First Circuit held Law 75 to be invalid as violative of due process under the United States Constitution, vacating the judgment of the District Court. The instant appeals are from that decision of the First Circuit.

ARGUMENT [1]

I. INTRODUCTORY.

Before proceeding to a discussion of the constitutional principles which make it clear that there are no substantial questions requiring argument before this Court, it will be helpful to comment briefly on certain allegations made by Appellant Fornaris concerning the opinion of the First Circuit.

A. It is suggested by Appellant Fornaris that the Automobile Dealers' Day in Court Act,[2] has been placed under a "constitutional due process cloud" [3] by the First Circuit's opinion. The First Circuit, noting that proponents of Law 75 had invited a comparison with the Federal Act, listed the striking differences between the two. Those listed by the First Circuit, as well as others which are apparent from even a cursory comparison, may be summarized as follows:

1. The Federal Act was specifically intended for and limited to the subject of automobile distribution. Law 75 applies to every conceivable "distribution, agency, concession, or representation of a given merchandise or service".[4]

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[1] A study of both jurisdictional statements reveals that the Jurisdictional Statement of Appellant Fornaris not only embraces all the arguments advanced by The Commonwealth of Puerto Rico, but also offers additional matters for the Court's consideration. Accordingly, the Argument section of this motion, while addressed to both appeals, will respond specifically only to the Jurisdictional Statement of Appellant Fornaris. References to the Jurisdictional Statement of Appellant Fornaris will be designated "JSF p. —."

[2] 15 U.S.C. §§ 1221-1225.

[3] JSF p. 17.

[4] Law 75, § 1(a); 10 L.P.R.A. § 278(a).

2. The Federal Act is applicable to written contracts.[5] Law 75 is applicable to "dealer's contract[s]" defined as a "relationship established between a dealer and a principal . . . whereby . . . the former actually and effectively takes charge of the distribution of a merchandise, or of the rendering of a service, by concession of franchise on the market of Puerto Rico."[6] Hence, a manufacturer who may previously have had only a "working relationship with a local dealer, now under Law 75 has a nonterminable "dealer's contract".

3. The Federal Act does not impose new contractual obligations upon either of the parties, but simply prohibits them from acting in a coercive manner. Absent coercion, intimidation or threats thereof, the manufacturer under the Federal Act may avail himself of all of his rights under the franchise agreement including his right to cancel the contract upon expiration, even if his decision is arbitrary.[7] Law 75 effectively rewrites the termination provisions of all dealer contracts. Contracts formerly terminable on 30 days written notice by both parties may still be terminated on notice by the distributor,[8] but the manufacturer

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[5] 15 U.S.C. § 1221(b).

[6] Law 75, § 1(b); 10 L.P.R.A. § 278(b).

[7] *Berry Brothers Buick, Inc.* v. *General Motors Corp.*, 257 F. Supp. 542 (E.D.Pa. 1966), *aff'd per curiam*, 377 F.2d 552 (3d Cir. 1967).

[8] *Cf. Castillo* v. *Smart Products, Inc.*, 289 F.Supp. 138 (D.C.P.R. 1968) in which defendant in a Law 75 action counterclaimed alleging that the plaintiff distributor was responsible for termination of the distribution agreement and claiming damages. The Court dismissed defendant's counterclaim noting

> "The Court likewise finds and concludes that in rescinding the distributorship agreement without alleging cause or justification, and without any notice in advance to the defendant plaintiff did not incur in any breach of said agreement, which contained no provision on either of said two points."

may only terminate if the distributor has given "just cause", a term narrowly defined by Law 75.[9] Absent the "just cause" of the statute, he would be in violation of Law 75 regardless of the economic necessity for the termination and regardless of the absence of intimidation or coercion.

4. Damages under the Federal Act are compensatory.[10] The damages provision of Law 75 is almost penal in its harshness. The "good will" of the distribution business must in effect be paid for twice,[11] and no allowance is made for possible contributions made by the manufacturer (*e.g.*, use of his trademark, contributions to local advertising budgets, etc.) or even a prior dealer toward the creation of that good will.

In summary, the Federal Act starts with an existing written contractual relationship which it leaves unchanged but requires that the parties not act in a coercive manner towards each other, and provides for compensatory damages if there is a failure in that regard. Law 75 starts with as little as a working relationship, promotes this into a "dealer's contract," provides for its non-termination by the principal and finally provides for payment of an indemnity which bears little relation to compensation.

The First Circuit observed that any comparison of Law 75 with the Federal Act was "ill-taken" because "it is precisely to the extent that Law 75 departs from

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[9] "just cause: nonperformance of any of the essential obligations of the dealer's contract, on the part of the dealer, or any action or omission on his part that adversely and substantially affects the interests of the principal or grantor in promoting the marketing or distribution of the merchandise or service." Law 75, § 1(d); 10 L.P.R.A. § 278(d).

[10] 15 U.S.C. § 1222.

[11] Law 75, §§ 3(c) and (d); 10 L.P.R.A. §§ 278(b), (c) and (d).

the provisions of that statute that it is in difficulties."[12] The court concluded that:

> "Comparing Law 75 with the Federal Act in terms of retrospectivity is, in a sense, merely an intellectual exercise. The parties have cited no case holding even the Federal Act constitutionally retrospective. Non constat, in the light of the differences, that it might properly be so held had the question arisen. Law 75, however, cannot be."[13]

In the light of the First Circuit's express recognition that there are substantial differences between the two acts insofar as retrospectivity is concerned, it is inaccurate to charge that Court with casting a "constitutional due process cloud" over the Federal Act.

B. Secondly, the First Circuit is charged with:

> ". . . refusal to give more than lip service to the established police power of Puerto Rico to safeguard what it conceives to be the vital interests of its people and its economy. The court acknowledged but rejected the public purposes underlying the legislation penalizing arbitrary cancellation of franchises—the frustration of dealers' legitimate expectations and interests, the resulting instability of local investments and export of profits, and the loss of some business to Puerto Rico's detriment."[14]

This charge is patently wrong as a reading of the opinion will demonstrate. The court reviewed the purposes of the act in some detail "not only because it shows the purposes of the act, illuminating the propriety, or possibly, impropriety of its provisions, but

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[12] JSF p. 40.

[13] JSF p. 41.

[14] JSF p. 21.

also because of the assistance it may give in resolving doubts as to the statutory meaning." [15]

The First Circuit did nothing more or less than to pursue the lines of judicial inquiry demanded in any case in which a statute is challenged as, *inter alia*, offending due process. It concluded that the action of the legislature was beyond the scope of the police power because of the retrospective alteration of contract rights. And, in passing, it commented on the illogic of one aspect of the legislative history as follows:

> "... the Report of the Committee on Industry and Commerce to the effect that the termination of dealerships in terms revocable at will was 'frustrating the legitimate expectation' of the dealers cannot possibly be true. Dealers may have had hopes; they could have no legitimate expectation of non-terminable contracts. *Cf. Castillo* v. *Smart Products, Inc.*, D.P.R., 1968, 289 F. Supp. 138."

The cited case amply supports the First Circuit's view of the matter. As for the Report of the Committee on Industry and Labor,[16] it is difficult to escape the conclusion that the chief purpose from the outset was to grant to a small group of local distributors the right to maintain their status or to collect a substantial indemnity.

To characterize the First Circuit's analysis as only paying "lip service to the established police power of Puerto Rico" and a rejection of "the public purposes underlying the legislation" is unwarranted.

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[15] JSF pp. 34-35.

[16] This Report, appearing in JSF pp. 53-55, was quoted by the Superior Court of Puerto Rico in its opinion in the *Construction Machinery* case, which opinion was adopted by the District Court below, JSF p. 46.

II. LAW 75 IMPAIRS THE OBLIGATIONS OF CONTRACT AND DENIES DUE PROCESS.

This Court has always recognized that while the police power is extremely broad in scope, it is not absolute. There are constitutional limitations on its exercise.[17] The First Circuit correctly concluded that these limitations had been exceeded. Despite the obscurantist attack on the opinion below as involving a "'constitutional rearrangement" and "contract impairment and due process misconceptions" [18] it is clear that Law 75 is unconstitutional whether tested under the Contract Clause (because Puerto Rico is to be treated as a State) or the Due Process Clause of either the Fifth or the Fourteenth Amendment.[19]

Contract Clause

The limitation on the power of a State to impair the obligations of contract (protected under Article I, Section 10) was succinctly and clearly stated in *Home Building & Loan Assn.* v. *Blaisdell,* 390 U.S. 398, 431 (1934) as follows:

> "The obligations of a contract are impaired by a law which renders them invalid or releases or extinguishes them, and impairment . . . has been predicated of laws which without destroying con-

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[17] These limitations obviously apply to Congress when legislating for the District of Columbia, *Berman* v. *Parker,* 348 U.S. 26, 31-32 (1954), and *a fortiori* to Puerto Rico when legislating under its federally derived constitution.

[18] JSF pp. 19 and 21.

[19] Since the substantive content of the Due Process Clauses of the Fifth and Fourteenth Amendments are identical insofar as deprivation of property is concerned, *Nebbia* v. *New York,* 291 U.S. 502, 525, (1934) it is immaterial for due process purposes whether Puerto Rico is classified as a State or is otherwise classified.

tracts derogate from substantial contractual rights."

It is apparent from a mere inspection of Law 75 that, if it does not destroy the manufacturers contract, it "derogate[s] from substantial contractual rights."

Simply stated, prior to the enactment of Law 75 a manufacturer, who had entered into a contract with a dealer which reserved to either or both the unilateral right to terminate such contract, could exercise his termination rights unconditionally and without liability. Moreover, prior to Law 75, he could exercise his obvious right to decline to renew an expired contract with a dealer. In neither case was a manufacturer first required to establish "just cause." [20]

Subsequent to the passage of Law 75, the manufacturer's right to terminate or decline to renew can only be exercised with impunity if it passes muster under the statutory definition of "just cause." No longer is the manufacturer free to choose his representatives. Now when a dealer insists on retaining his status, the manufacturer must opt either to pay damages by way of settlement to avoid litigation or submit to litigation and assume the burden of showing "just cause" for the termination.

By any standard this constitutes a derogation of "substantial contractual rights" and is forbidden by Article I, Section 10. Where the validity of a retrospective statute is called into question this Court has weighed the public welfare it purports to serve against the unfairness created by its retrospective operation. *El Paso* v. *Simmons*, 379 U.S. 497 (1965); *Home Build-*

[20] See footnote 9, *supra*.

ing & Loan Association v. *Blaisdell, supra; Block* v. *Hirsh,* 256 U.S. 135 (1921). See also Hochman, *The Supreme Court and the Constitutionality of Retroactive Legislation,* 73 Harv. L. Rev. 692, 727 (1960).

In *El Paso* v. *Simmons, supra* at 509, this Court, quoting from *Ogden* v. *Saunders,* noted that

> "[i]t is the motive, the policy, the object, that must characterize the legislative act, to affect it with the imputation of violating the obligation of contracts."

The Court then examined in detail the historical background and economic considerations which led up to the 1941 amendments to the Texas law which were the subject of constitutional challenge and concluded at 513:

> "It was this situation to which the Texas Legislature addressed itself in 1941 and it is the light of this situation that we judge the validity of the amendment."

Balancing the public good against the private loss, the Court upheld the statute as designed to "restore confidence in the security and integrity of land titles, and to enable the State to protect and administer its property in a business-like manner" observing that the legislative "measure taken . . . was a mild one indeed." 379 U.S. 511-512.

And in *Block* v. *Hirsh, supra,* this Court noted the existence of "emergencies growing out of the war resulting in rental conditions in the District dangerous to the public health" which justified a rent control statute as a "regulation . . . justified only as a temporary measure . . . . A limit in time, to tide over a passing trouble, may well justify a law that could not

be upheld as a permanent change." 256 U.S. at 154, 157.

Similarly, in *Blaisdell, supra,* this Court cited "the economic emergency which threatened 'the loss of homes and lands which furnish those in possession the necessary shelter and means of subsistence' " 290 U.S. at 444-445, and upheld a Minnesota mortgage moratorium statute finding not only that the statute afforded relief to mortgagees as well as mortgagors, but also that the "legislation is temporary in operation." 290 U.S. at 445-447.

None of the foregoing cases, nor any other case decided by this Court, support the contention of Appellant Fornaris that, in judging infractions of the Contract Clause "[t]he critical factor is thus not the factor extent of the impairment but the reasonableness or necessity of the exercise of state police power." [21] It is not true that the severity of the derogation wrought by Law 75 can be justified by either its economic objectives or the means adopted to achieve them. This Court made that perfectly clear in *El Paso, supra,* at 508-509. There, relying upon *Blaisdell, supra,* it observed that the reserve power of a State to modify the obligations of contract cannot be construed to destroy the limitations of the Contract Clause. Accordingly, the Court concluded, quoting from *Blaisdell, supra,* at 439:

> "They must be construed together. This principle precludes a construction which would permit the State to adopt as its policy the repudiation of debts or the destruction of contracts or the denial of means to enforce them."

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[21] JSF p. 23.

Following the principles announced in *Blaisdell*, the Court has never been deterred from invalidating well-intentioned police power legislation which transgressed the limitations of the Contract Clause. *W. B. Worthen Co.* v. *Thomas*, 292 U.S. 426 (1934); *W. B. Worthen Co.* v. *Kavanaugh*, 295 U.S. 56 (1935). In the latter case the Court stated: "Even when the public welfare is invoked as an excuse, these bounds must be respected." 295 U.S. at 60.

The First Circuit in considering Law 75 did nothing more than to follow the methodology employed by this Court in considering retrospective legislation. After considering *Blaisdell*, *El Paso*, and *Block* v. *Hirsh*, *supra*, and other cases, it concluded that Law 75 breached the outermost limits of those cases.

Due Process

Conceding to Puerto Rico the fullness of the police power that is enjoyed by the several States and by Congress in legislating for the District of Columbia, Law 75 is unconstitutional as a deprivation of property without due process of law.

It is clear that for due process purposes that "[v]alid contracts are property, whether the obligor be a private individual, a municipality, a State or the United States." *Lynch* v. *United States*, 292 U.S. 571, 579 (1934), *Thorpe* v. *Housing Authority*, 393 U.S. 268, 278, n. 31 (1969). And rights against the United States arising out of a contract with it are protected by Fifth Amendment against retrospective alteration. *Lynch*, *supra*, at 579. So also the Fifth Amendment protects contracts between private parties from unwarranted interference by Congress. As stated by the

Court in *Continental Illinois National Bank* v. *Chicago, Rock Island & Pacific Ry. Co.*, 294 U.S. 648, 680 (1935):

> "... as far back as Calder v. Bull, 3 Dall. 386, 388, it was said that among other acts which Congress could not pass without exceeding its authority was 'a law that destroys or impairs the lawful private contracts of citizens.' The broad reach of that statement has been restricted (Legal Tender Cases, 12 Wall. 457, 549-550); but the principle which it includes has never been repudiated, although the extent to which it may be carried has not been definitely fixed."

In the case of the several States, Article I, Section 10, standing alone, provides protection against impermissible retrospective alteration of private contracts and there is no need to resort to the Due Process Clause of the Fourteenth Amendment. *W. B. Worthen Co.* v. *Thomas, supra; W. B. Worthen Co.* v. *Kavanaugh, supra.*

This Court, however, has never considered the Due Process Clauses of the Fifth and Fourteenth Amendment and the Contract Clause as constitutional pigeonholes conceptually isolated from each other. For example, in *Thorpe* v. *Housing Authority of Durham, supra,* a Fifth Amendment due process case, this Court (393 U.S. at 278-280) called attention to its prior decisions in *Blaisdell* and *El Paso, supra,* both Contract Clause decisions. *Blaisdell* provided the reserve situation, where the question before the court was a Contract Clause matter, and this Court relied heavily upon *Block* v. *Hirsh, supra,* a Fifth Amendment due process case. In *Blaisdell,* after examining the pertinent issues and upholding the action of the State of Minnesota under the Contract Clause, this Court proceeded to overrule

the Fourteenth Amendment due process contention by noting at pp. 447-448:

> "What has been said on that point [the Contract Clause] is also applicable to the contention presented under the due process clause. *Block* v. *Hirsh*, 256 U.S. 135. . . ."

It is apparent from the foregoing that retrospectivity is a factor traditionally considered by this Court whether the alteration of contract rights is to be tested under the Fifth Amendment, the Fourteenth Amendment or the Contract Clause. It was unnecessary, therefore, for the First Circuit to determine whether Puerto Rico is properly subject to the due process clause of the Fifth or the Fourteenth Amendments. The result is the same in either case.

The suggestion of Appellant Fornaris[22] that *Ferguson* v. *Skrupa*, 372 U.S. 726 (1963) and *Day-Brite Lighting Inc.*, 342 U.S. 421 (1952), permit the police power absolute sway, without regard to the severity of the impact resulting from retrospective legislation thus finds no support in the cases. Indeed, it is precisely the severity of retrospective impact which has led this court, in a Fourteenth Amendment due process case, to announce the principle that:

> "As long recognized, some values are enjoyed under an implied limitation, and must yield to the police power. But obviously the implied limitation must have its limits or the contract and due process clauses are gone. One fact for consideration in determining such limits is the extent of the diminution. When it reaches a certain magnitude, it must if not in all cases there must be an exercise of eminent domain and compensation to sustain

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[22] JSF p. 23.

> the act. So the question depends upon the particular facts. The greatest weight is given to the judgment of the legislature, but it always is open to interested parties to contend that the legislature has gone beyond its constitutional power." *Pennsylvania Coal Co.* v. *Mahon*, 260 U.S. 393, 413 (1922).

No one would seriously argue that the statute involved in *Pennsylvania Coal Co.* v. *Mahon* did not meet the criteria announced in *Ferguson* v. *Skrupa* and *Day-Brite Lighting Inc.* v. *Missouri*. Nevertheless the statute which would have destroyed the coal company's reserved right to mine coal under land, the balance of which had been sold by it, worked a change of such great magnitude that it was felt that it was beyond the reach of the police power. It is submitted that neither *Ferguson* v. *Skrupa* nor *Day-Brite Lighting Inc.* v. *Missouri* has watered down or removed from the law the principle announced in *Pennsylvania Coal Co.* v. *Mahon*.

The First Circuit was dealing with "practical and substantial rights" with which "[t]he Constitution is concerned." *F.H.A.* v. *The Darlington, Inc.*, 358 U.S. 84, 91 (1958). The Court concluded that "to convert a contractual relationship terminable by either party without cause into one which, short of breach by the other party, can be terminated by one of the parties only by making substantial payments and without protection for the other parties interests, is . . . a change of great magnitude."[23]

In so concluding its judgment is unassailable.

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[23] JSF p. 39.

III. LAW 75 PLACES AN UNDUE BURDEN UPON COMMERCE BETWEEN PUERTO RICO AND THE SEVERAL STATES.

Regardless of whether Puerto Rico is considered to be governed by the Commerce Clause[24] of the Federal Constitution or by the Territorial Clause,[25] it is a part of the federal system. Hence it is within the exclusive power of Congress to regulate commerce between Puerto Rico and the states to assure harmony within the federal system. The necessary concomitant of this premise is that Puerto Rico does not have the power to legislate in a manner which would unduly burden commerce between Puerto Rico and the several states. This, however, is exactly the effect of Law 75.

The burdens visited upon commerce by Law 75 are formidable. Substantial entry barriers are erected, directly violative of this Court's ruling in *Dean Milk Co. v. Madison*, 340 U.S. 349 (1951). A manufacturer presently dealing through an exclusive distributor is effectively prevented from appointing another distributor, or entering the market himself; or even withdrawing from the market as his own business judgment may dictate. Even if confronted with primary line competition from another manufacturer not using an exclusive distributor, he would not be able to make the necessary adjustment to remain competitive without payment of a Law 75 indemnity.

Uniform regulation of interstate commerce is the only alternative to economic chaos in the federal system. The founding fathers recognized this principle

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[24] Article I, Section 8, Clause 3.

[25] Article IV, Section 3, Clause 2.

and this Court has consistently applied it. Puerto Rico, regardless of its exact legal status, is no less subject to this authority of Congress.

IV. LAW 75 IS NOT CONSISTENT WITH THE ANTITRUST LAWS AND POLICIES OF THE UNITED STATES AND MUST YIELD TO THE SUPREMACY CLAUSE OF THE CONSTITUTION.

Law 75 deprives a manufacturer of the control and flexibility it is entitled to exercise with respect to its distribution arrangements. The Court of Appeals aptly recognized that this statute makes a dealer's contract, with certain exceptions, "renewable indefinitely at the option of the dealer, and impose[s] substantial damages upon a manufacturer who refuse[s] to accede." [26] Thus, Law 75 operates to give existing dealers the power to exclude potential competitors and thus perpetuate indefinitely the *status quo*, whether it be a satisfactory distribution arrangement in terms of benefits to the public and the manufacturer, or not.

Such restrictions on the manufacturer run counter to United States antitrust laws and policy and, accordingly, Law 75 must yield to the Supremacy Clause of the Constitution.[27]

Repeatedly, where the courts have dealt with the question of whether and to what extent a manufacturer may select its customers, it has been held that the manufacturer has a fundamental right under the Sherman Act to choose its customers. *United States* v. *Colgate & Co.*, 250 U.S. 300 (1919). Accordingly, it may franchise as many or as few dealers as it wishes. The manufacturer may even grant exclusive dealerships,

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[26] JSF p. 32.

[27] Article VI, Clause 2.

providing the dealer with an exclusive territory and agreeing not to compete itself or locate another distributor in the assigned area. See *e.g., Schwing* v. *Hudson Sales Corp.*, 138 F. Supp. 899 (D. Md. 1956), aff'd. 239 F.2d 176 (4th Cir. 1956), *cert. denied*, 355 U.S. 823 (1957). The courts also have recognized the manufacturer's concomitant right to substitute one dealer for another, *Scanlon* v. *Anheuser-Busch, Inc.*, 388 F.2d 918 (9th Cir. 1968), *cert. denied*, 391 U.S. 916 (1968); to appoint a number of competing dealers, *Industrial Building Materials, Inc.* v. *Interchemical Corp.*, 278 F. Supp. 938 (C.D. Cal. 1967); and to itself take over a distributor's dealership, *B & B Oil & Chemical Co.* v. *Franklin Oil*, 293 F. Supp. 1313 (E.D. Mich. 1968). The theory of these cases is that if manufacturers are deprived of flexibility to modify their vertical distribution programs and are required to preserve the presently existing structures, there is a "resultant definite, not fanciful, restraint on the freedom of competition," *B & B Oil & Chemical, supra*, at 319.

Law 75 does not recognize such rights and, in fact, clearly abridges them. It would require Appellee to adhere to its present arrangement with Appellant despite changes in Puerto Rico's economy or in Appellee's own particular business requirements, factors which would seem clearly to justify revisions of a manufacturer's distribution program.

This rigidity which Law 75 imposes on a manufacturer has the effect of providing territorial security and a resultant *de facto* monopoly for existing exclusive distributors in Puerto Rico because of the isolated nature of the island economy. The average consumer cannot readily go into another area to purchase the

products offered by such exclusive distributors, nor can a stateside manufacturer readily do business in Puerto Rico, except through a local representative. Thus, the consumer is captive to the existing arrangement. See *Galbraith & Holten, Marketing Efficiency in Puerto Rico,* Harvard University Press (1955) at pp. 194-96. The territorial security which Law 75 sanctifies is the very type which a manufacturer is forbidden to impose under the antitrust laws. Once the manufacturer has parted with title to its products, it is a *per se* violation of Section 1 of the Sherman Act[28] for it to attempt to restrict or confine its dealers with respect to areas in which its products may be sold. *United States* v. *Arnold, Schwinn & Co.*, 388 U.S. 365 (1967). Underlying this rule is the theory that "unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress .... But even if that premise were open to question, the policy unequivocally laid down by the [Sherman] Act is competition." *Northern Pacific Ry. Co.* v. *United States,* 356 U.S. 1, 4 (1958).

For the above reasons, Law 75, though "state action," is inconsistent with the antitrust laws and must yield to the Supremacy Clause of the Constitution. See *Schwegmann Bros.* v. *Calvert Distillers Corp.*, 341 U.S. 384 (1951).

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[28] 15 U.S.C. § 1.

V. THE DOCTRINE OF ABSTENTION IS INAPPLICABLE.

A. This case is governed by *Harman* v. *Forssenius*, 380 U.S. 528 (1965) wherein the Court said at 535:

> "If the state statute in question, although never interpreted by a state tribunal, is not fairly subject to an interpretation which will render unnecessary or substantially modify the federal constitutional question, it is the duty of the federal court to exercise its properly invoked jurisdiction."

No construction of Law 75 can "render unnecessary or substantially modify" the federal constitutional questions it raises.

It is apparent that Law 75 deprives a manufacturer of fundamental contract rights. Under Law 75 he may neither terminate nor decline to renew a contract with a dealer without "just cause." It is precisely this legislative conditioning of the right to terminate which raises the constitutional difficulties resolved by the First Circuit.

Law 75 is clear and unambiguous in its purpose to impose "just cause" as a condition of the exercise of termination rights. Contrary to the suggestion of Appellant Fornaris,[29] it would make no sense to require abstention on the chance that the Supreme Court of Puerto Rico could or would interpret Law 75 so as to eliminate "just cause" as a condition of the right to terminate. It is obvious that any such construction would be tantamount to repealing an essential part of the statute. This Court has refused to require abstention on the possibility that a state court would adopt an obviously strained construction. *Harman* v. *Forssen-*

[29] JSF p. 27 n. 18.

ius, Supra, at 536. Cf., *Davis* v. *Mann,* 377 U.S. 678, 691 (1964).[30]

Equally unconvincing is the suggestion that Law 75 might be construed by the Supreme Court of Puerto Rico as prospective and not retrospective. Not only would such an interpretation run exactly counter to the clear legislative intent, but the Supreme Court of Puerto Rico has already declined to adopt this view. On the same day the First Circuit decided the case below, the Supreme Court of Puerto Rico, in *McGregor-Doniger, Inc.* v. *Tribunal Superior de Puerto Rico,* 63 Colegio de Abogados (Case No. 0-69-159 decided on March 17, 1970),[31] reversed a decision of the Superior Court of Puerto Rico which had refused to stay proceedings under a Law 75 claim and give effect to an arbitration clause. In that case a contract of "employment" had been entered into containing a clause which provided that the parties would refer to arbitration in the State of New York any controversy or claim which might arise between them under the contract. The contract also provided that the appellee would dedicate himself to the promotion and sale of appellant's products in Puerto Rico, accepting responsibility for the distribution of the merchandise in Puerto Rico and a 4% commission for his efforts. The

[30] So also, any construction of "just cause" to expand its scope to include exculpating reasons for terminating a dealer's contract in addition to those specifically set forth in the statutory definition would not render Law 75 safe from constitutional challenge. See JSF p. 24 n. 17 (1) and opinion of Superior Court of Puerto Rico in *Construction Machinery & Supplies Corporation* v. *Construction Machinery Co.*, JSF p. 57. Any amelioration provided by a more expansive construction of "just cause" would still have the effect of conditioning the termination rights of the manufacturer.

[31] Reprinted as an Appendix hereto is an unofficial English translation of the opinion.

contract provided for cancellation on 30 days' notice. Thereafter the principal cancelled "due to changes which are now being made in our sales representation throughout the world," stating that "we regret that our efforts during the past season have not generated the sales volume that we both would have wished for."[32] In reversing the lower court, the Supreme Court of Puerto Rico said:

> "It is apparent from the pleadings that the cancellation of the contract in this case 'due to changes which we are now making in our sales representation throughout the world' is cause to cancel it since in the contract it was agreed that it could be cancelled by 30 days' written notice. But it is also clear that such cause or reason is not the 'just cause' which permits the termination of a distribution contract in accordance with the provisions of Law 75, supra.'"[33]

The court then stated in the footnote reference:

> "Art. 1 of Law 75 defines just cause as the breach of any of the essential obligations of the distributorship contract on the part of the distributor or any action or omission on his part which substantially and adversely affects the interest of the principal or grantor in the development of the market or distribution of the merchandise or service."[34]

Thus the Supreme Court of Puerto Rico declined to dispose of the case, as it easily could have, on the ground that Law 75 operates prospectively and not retrospectively. Instead, the court sent the case to arbitration to determine, among other questions, "if there was just cause to cancel [the contract] under Law 75."[35] In so

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[32] Appendix, p. 2a.

[33] Appendix, p. 6a.

[34] Appendix, p. 6a.

[35] Appendix, p. 6a.

doing the court made clear its view that the "just cause" which would excuse the contract cancellation is only the literal definition in the statute itself.

B. In support of its argument on abstention, Appellant suggests that the First Circuit rendered an "advisory opinion" in a "factual vacuum,"[36] and that it unnecessarily anticipated and decided a constitutional question.

Appellant cites *Electric Bond & Share Co.* v. *S.E.C.*, 303 U.S. 419 (1938) for the proposition that Chief Judge Aldrich improperly entered into a "speculative inquiry" and overturned as unconstitutional a statute "the effect of which in concrete situations, not yet developed, cannot now be definitely perceived."[37] In *Electric Bond & Share*, however, unlike the instant case, there was presented, in the words of the Court at 443, "a variety of hypothetical controversies which may never become real." The controversy which produced the instant litigation, on the other hand, is anything but hypothetical. Here, Appellant Fornaris brought suit against Appellee alleging that Appellee had terminated Appellant's 29-year distributorship contract; that the termination was without just cause and illegal in Puerto Rico; and that Appellant was entitled to indemnification of $175,000. Appellee's motion to dismiss put the constitutionality of Law 75 directly and unavoidably into question.

C. The prompt resolution of a matter of urgent public interest strongly militates against invoking the abstention doctrine. The proceedings in this case have been pending for more than four years. There are

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[36] JSF p. 28.

[37] JSF p. 29.

presently pending in the federal district court and the local courts over 60 cases involving alleged violation of Law 75. The aggregate of claims is conservatively $25 million. A remand of this case would mean additional delay of no less than four years in securing final decision by the Supreme Court of Puerto Rico. Additional time will be consumed in a rehearing of the federal questions by the federal courts including, perhaps, ultimate resort to this Court.[38] If this case is remanded, it and many others will be doomed to spend years in litigation before a final decision is reached.

CONCLUSION

WHEREFORE, Appellees Ridge Tool Company and Ridge Tool International Co., Inc., respectfully submit that the questions upon which this cause depends are so unsubstantial as not to need further argument, and Appellees respectively move the Court to dismiss these appeals or, in the alternative, to affirm the judgment entered in the cause by the United States Court of Appeals for the First Circuit.

Respectfully submitted,

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[38] See *England* v. *Louisiana State Board*, 375 U.S. 411 (1964).

APPENDIX

(Opinion No. 70-63)

IN THE SUPREME COURT OF PUERTO RICO

No. 0-67-159

McGREGOR-DONIGER, INC., *Petitioner*

v.

SUPERIOR COURT OF PUERTO RICO, SAN JUAN SECTION, HON. ARMINDO CADILLA GINORIO, Judge, *Defendant*

Opinion of the court written by associate judge RAMIREZ BAGES.

In San Juan, Puerto Rico, the 17th of March, 1970.

The petitioner cancelled its contract with the appellee. The contract was executed in 1959. Under its terms, the appellee agreed to promote and sell petitioner's products in Puerto Rico, in return for which he would receive a 4% commission on the net shipments. We must decide in this case whether to enforce the arbitration clause contained in the contract, calling for arbitration of any controversy arising as a result of the breach of same, or whether the rights of the parties are to be determined exclusively on the basis of Law # 75 approved by the Legislative Assembly of Puerto Rico, June 24, 1964 (10 L.P.R.A. secs. 278 and 278 a-d).

The complaint in this case alleged (1) that the parties executed, effective January 1, 1959, a contract, entitled an employment contract, by virtue of which the appellee agreed among other things, to dedicate himself to the sales and promotion of petitioner's products in Puerto Rico; to accept a 4% commission on net shipments as payment for his services; and assume full responsibility for the distribution of the merchandise in Puerto Rico. It was agreed that the contract would expire on the 31st of December, 1959, or before this date, by either party, upon written notice to the

other, sent by certified mail with 30 days prior notice. However, if when the contract expired, the "employer" was still rendering his services, the terms of the contract would apply to the continued employment; (2) that the contract is governed by the laws of New York and any controversy, or claim which arises from, or is related to said contract, or its breach, or to employment under the same, will be decided by arbitration in the City of New York according to the rules of the American Arbitration Association and any court with jurisdiction over the subject matter will render a verdict in accordance with the award; (3) said contract was cancelled by the defendant, effective January 7th, 1967 without having any justifying cause or motive. The cancellation letter states that said cancellation is "due to changes which are now being made in our sales representation throughout the world. . ." That "we regret that our efforts during the past season have not generated the sales volume that we both would have wished for. However, we appreciate the interest you have always shown in Mc Gregor"; (4) that the appellee increased the sale of petitioner's products from $75,000.00 before the contract to $192,000.00 in 1965; they fell to $130,000.00 in 1966 because sizable orders were not sent to a client; (b) That the petitioner refuses to pay to the appellee the sales commissions corresponding to 1967 and for the cancellation of the contract as required by law # 75, approved the 24th of June, 1964, and thus owes the appellee the sum of $43,365.60.

The petitioner denied (1) that the appellee was an exclusive agent and representative for the Puerto Rico territory under the contract; (2) that the appellee fulfilled all of his obligations diligently; (3) that the contract was cancelled without a cause or motive to justify such action; (4) that the appellee had increased sales in the amount claimed; and (5) the claim at issue. The petitioner alleged as special defenses that (a) the appellee agreed to act as an employee and therefore cannot claim under Law # 75 which was passed to protect distributors and not employees of manu-

facturing houses; (b) that the parties agreed to submit to arbitration any controversy arising under the contract; and (c) that the contractual relationship of the party should be governed by the laws of New York, as was stipulated in the contract; and (d) that Law # 75 is unconstitutional and so is its application to this case.

The petitioner submitted a motion to stay the proceedings, pending arbitration. The appellee objected because his cause of action was based on a violation of the provisions of Law # 75 and because arbitration in New York would be extremely onerous for him. The lower court held that Law # 376 of May 8, 1951 (32 L.P.R.A. sec. 3201) regulates the procedure for commercial arbitration in Puerto Rico, that said law does not authorize the court to order an arbitration proceeding outside this jurisdiction; that as the court cannot "order the celebration of arbitration proceedings in the state of New York, it would be unfair to paralyze the proceedings in this case". On reconsideration, the lower court re-affirmed its refusal to stay proceedings pending arbitration in view of the public policy contained in Law # 75 and because many state courts have refused to order arbitration in a jurisdiction different from the one of the forum, on the theory that a sovereign will not order its citizens to go before another sovereign to arbitrate their disputes.

The petitioner points out that the lower court erred in holding that because Law # 376, supra, does not authorize the court to order arbitration in New York, it would be unjust to stay the proceedings in this case.

In support of this position, the petitioner argues that in *Hilti, Inc.* v. *Oldach*, 392 F.2d 368 (CCA 1 1967), it was held that the proceedings in the United States District Court for Puerto Rico, in an action brought alleging the termination of a distributorship contract in violation of Low # 75 supra, were to be stayed pending arbitration in the state of Connecticut as provided for in the contract; that the power of the courts to order the proceedings

stayed pending arbitration is not based on the judicial authority to order arbitration in another jurisdiction; that the arbitration law that governs the controversy is the federal arbitration law as it is a transaction in interstate commerce. (9 U.S.C.A. secs. 1 and 2); that if the federal arbitration law does not apply, then the arbitration law of the state of New York applies as it was the one chosen by the parties; that the existing doctrines [are] to the effect that both the state and the federal courts have the authority to stay the proceedings until the parties have gone to arbitration in the agreed forum; that the argument that this would defeat public policy was rejected in *Hilti, Inc.*, supra.

The appellee argues that (1) this action does not arise from an interpretation of the contract at issue, but from its cancellation without just cause in violation of the provisions of law 75, supra; (2) due to the action of the petitioner, the contractual relationship between the parties has ceased, and therefore "Law #75 of 1964 as amended enters immediately with full force"; (3) that we are not bound by the decisions of the federal courts, because it is the courts of the Commonwealth of Puerto Rico who must interpret and give the necessary scope to the local law which governs the case; (4) neither the federal arbitration law nor Puerto Rico's forces a court to order arbitration outside its jurisdiction; (5) the petitioner answered the complaint, took appellee's depositions; used discovery of proof, and obtained permission to allege an additional defense; as a result of these acts, he renounced his right to arbitrate; that to hold arbitration in New York is extremely onerous for the appellee.

The petitioner alleges that its actions in this case cannot be interpreted as a waiver of its right to demand the agreed arbitration; indicates that according to *Tilti, Inc.*, supra, the courts have been reluctant to recognize a waiver of arbitration.

1—First we must decide whether the petitioner waived its right to arbitration. We conclude that it did not. The

burden of proving such a waiver falls on the appellee. There is a vigorous policy in favor of arbitration and a decided reluctance on the part of the courts to find that the right to arbitration has been waived. *Hilti, Inc.* supra. Any doubt that might exist must be decided in favor of arbitration. *Galt* v. *Libbey Owens Ford Glass Co.*, 376 F.2d 711 (CCA 7 1967).

It is alleged that the answering of the complaint, the alleging of special defenses, and the taking of depositions are acts inconsistent with the right to arbitration and therefore, such acts of active participation in the litigation constitutes a waiver of the right to arbitration.

This case is distinguishable from that of *Cornell & Company* v. *Barber & Ron Company*, 360 F.2d 512 (CCA Dist. of Co. 1966), in that in this latter case, arbitration was not invoked in the answer to the complaint, and many acts of participation, inconsistent with the right of arbitration, was carried out. *Gahon Iron Works & Mfg Co.* v. *J. D. Adam Co.*, 128 F.2d 411 (CCA 7 1942) is not applicable as there it was held that the plaintiff had waived his right to arbitrate by opting to litigate the issue in the courts.

The actions of the petitioner did not constitute a waiver of its right to arbitration because it invoked that right in its first pleading in the case, and requested a stay of the proceedings pending the arbitration which had been agreed to in the contract. Its subsequent actions were limited and not inconsistent with its original position of insistence on arbitration. *Hilti, Inc.* supra; *Robert Lawrence Co.* v. *Devonshire Fabrics, Inc.*, 271 F.2d 402, 412 (CCA 2 1959) *Almacenes Fernandez, S.A.* v. *Golodeltz*, 148 F.2d 625, 627 (CCA 2 1945).

2—As the contract in issue involves a transaction in interstate commerce, its arbitration clause is governed by the Federal Arbitration Law. Said federal law authorizes the staying of proceedings in order that arbitration may proceed in accordance with the agreement (9 USCA Sec. 3)

Prima Paint Corp. v. *Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1966). The Puerto Rico arbitration law contains an almost identical provision (32 L.P.R.A. Sec. 3203).

3—The fact that arbitration has been agreed to in another forum does not constitute an impediment to the staying of proceedings in a litigation until the issues in controversy have been arbitrated, in accordance with a previously stipulated arbitration agreement between the parties. *Hilti, Inc.* supra; *Gutierrez* v. *Union Pacific Railroad*, 372 F.2d 121 (CCA 10, 1966); *Armtorg Trading Corp.* v. *Camden Fiber Mills*, 109 N.E. 2d 606 (N.Y. 1952); *Shanferoke Coal & Supply Corp.* v. *Westchester S. Corp.*, 70 F.2d 297 (CCA 2 1934).

It is apparent from the pleadings that the cancellation of the contract in this case "due to changes we are now making in our sales representation throughout the world" is cause to cancel it, since in the contract it was agreed that it could be cancelled by 30 days written notice. But it is also clear that such cause or reason is not the "just cause" which permits the cancellation of a distributorship contract in accordance with the provisions of Law # 75 *supra*.[1]

However, according to the federal arbitration law the proceedings in this case shall be stayed until by the arbitration agreed to by the parties the following has been determined: (1) the nature and efficacy of the contract in question; (2) the relationship of the parties under the contract; (3) if there was just cause to cancel same under Law # 75; (4) if the commissions alleged in fact 4 of the complaint are owed; (5) any other controversy that has arisen and is pending between the parties and the said contract.

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[1] Art. 1 of Law #75 defines just cause as the breach of any of the essential obligations of the distributorship contract on the part of the distributor or any action or omission on his part which substantially and adversely affects the interest of the principal or grantor in the development of the market or distribution of the merchandise or service.

It must be understood, however, that upon the conclusion of said arbitration, the proceedings in this case may be continued in form and manner not inconsistent with the arbitration award, determining at the outset the applicability of Law #75 to the contract in question, as well as its constitutionality.

Therefore, the resolutions of the Superior Court, San Juan Section, of October 2, 1968 and June 24, 1969 must be and are revoked and the proceedings in the case ordered suspended until the arbitration agreed to in the contract in question has taken place.

Signed/ MARIANO H. RAMIREZ BAGES
Associate Judge

Judgment

San Juan, Puerto Rico the 17th of March, 1970.

For the reasons stated in the above opinion, the resolutions of the Superior Court, San Juan Section, dated the 2nd of October, 1968, and the 24th of June, 1969 are hereby revoked and the suspension of the proceedings of this case is hereby ordered until the arbitration in accordance with the contract in question has taken place.

So held and ordered by the Court and certified by the Secretary. The Chief Judge and the Associate Judge Mr. Hernández Matos, did not intervene. The Associate Judges Messrs. Santana Becerra & Dávila concur in the result without opinion.

JOAQUIN BERRIOS—*Secretary*

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